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Washington Pushes Tokyo On Public Spending

Although no one is saying, American negotiators may have gotten the idea for a current trade initiative while waiting in Tokyo's main international airport, Narita. Bombarded with statistics and news stories about the Japanese economic juggernaut, Americans sometimes are surprised as they step off the plane at the relatively new facility. Compared to signs of unprecedented economic prosperity elsewhere in Japan, the country's airports and other public infrastructure appear neglected, at least to visitors from other industrial countries. Partly for these reasons, Washington has targeted public-sector investment as one of six broad categories under the Structural Impediments Initiative where it would like Tokyo to make major reforms. In particular, the United States is pressing Japan to increase fixed investment spending by the public sector to 10 percent of gross national product from the 6.5 percent level reached in calendar 1989 and expected for fiscal 1989, which ended March 31

(see Table 1). Such an increase would reverse a downward trend that had been expected to persist at least through FY 1990.

Table 1: Public Sector Investment and GNP

(in billions of yen)

	Actual			Estimated	Projected
	FY 1986	FY 1987	FY 1988	FY 1989	FY 1990
Nominal Public-Sector Fixed Investment	Y22,499.4	Y24,498.0	Y24,807.3	Y25,900	Y26,300
Nominal Gross National Product	334,601.3	351,366.1	372,500.0	396,500	417,200
Public-Sector Fixed Investment as Percent of GNP	6.7%	7.0%	6.7%	6.5%	6.3%
Nominal Growth Rate of Public-Sector Fixed Investment	5.0%	8.9%	1.3%	4.4%	1.5%
Real Growth Rate of Government Fixed Investment	7.0%	9.4%	1.2%	n.a.	n.a.

Source: Economic Planning Agency

Public-sector fixed investment, for which no comparable U.S. figure exists, is a component of GNP (see Table 2). In contrast to government current expenditures and public-sector inventory investment, it consists of outlays for relatively long-lived assets, such as buildings and equipment. As such, it includes a portion of spending by government at all levels and by other public-sector organizations. For example, local government and public corporation expenditures on harbor improvements get counted as investment, while central and local government education spending is considered government current expenditures. Simply including all public-sector education expenses -- an investment in youth in the view of many economists -- would lift the figure above 10 percent for most recent years. The diffuse nature and necessarily arbitrary definitions of public-sector investment make reaching any particular target a less than straightforward exercise. The FY 1989 general account budget figure of Y6.2 trillion ($41.3 billion at Y150=$1.00) in public works spending accounted for only a small portion of all public-sector investment during the April 1989-March 1990 period, suggesting the need to increase a series of public-sector budgets should Tokyo agree to Washington's request.

Especially considering the complexity of the subject, many Americans would be tempted to argue that Japan's infrastructure is its own business. After all, Americans would not readily accept criticism of this country's highways and bridges despite domestic debate on this subject, in part because foreigners would be deemed inappropriate evaluators of the divided responsibility

Table 2: Government's FY 1990 Economic Outlook: Real Gross National Product

(percent change)

	Actual			Estimated	Projected
	FY 1986	FY 1987	FY 1988	FY 1989	FY 1990
Real Gross National Product	2.7%	5.4%	5.3%	4.6%	4.0%
Consumer Spending	3.4	4.5	5.0	3.2	4.6
Residential Construction	11.0	25.7	5.3	0.2	0.3
Private Capital Spending	4.3	10.1	17.3	14.5	7.3
Business Inventories	-52.6	64.9	28.6	19.0	4.6
Government Spending*	7.7	2.1	1.3	5.7	2.5
Exports of Goods and Services and Factor Income Received	-3.7	5.4	10.7	15.4	10.6
Imports of Goods and Services and Factor Income Paid	5.4	12.4	21.4	19.3	13.0

*Includes public-sector current expenditures, fixed investment and inventory investment.

Note: FY 1989 estimates and FY 1990 projections are based on the economic outlook endorsed by the cabinet February 28, 1990.

Source: Economic Planning Agency

for such projects among federal, state and local governments. Surely Americans would bristle should a foreign country put a dollar amount on any suggested improvements. However, the SII talks have given the United States and Japan an opportunity for just such exercises, especially when a plausible case can be made that seemingly domestic problems have international implications. Washington presumably put its argument in this broader framework: if public fixed investment spending increases, then Japan's surplus of savings over investment declines, other factors being equal, putting less pressure on investors to find profitable outlets for their funds overseas. Should overseas investment decrease, the demand for dollars weakens compared to yen and that raises the value of the Japanese currency, leading eventually to a smaller Japanese current account surplus.

Of course this scenario is full of "ifs." One of the most important uncertainties involves government spending and tax policy. The Ministry of Finance has a long-standing policy of reining in -- with considerable success -- Japan's budget deficit. It recently announced a five-year goal of limiting bond issues for construction to less than 5 percent of revenue in the general account budget (see JEI Report No. 12B, March 23, 1990), down from 8.5 percent in the proposed FY 1990 budget. If MOF persists in this objective, increased public investment would probably have to come out of the expansion in revenues as the economy grows, at the expense of other government spending, or from a tax increase. Except for the first, these alternatives are politically unattractive. In addition, none would fulfill Washington's presumed objective of reducing the savings-investment imbalance in Japan. An increase in spending not tied to the general account could have the result that Washington seeks while enabling MOF to meet its new goal on construction bonds, but the Finance Ministry

probably would see this as taking a backward step in its effort to reduce the budget deficit.

In short, Washington wants broadly defined budget deficits in Japan to be larger; MOF wants them smaller. No wonder then that negotiators on both sides of the SII talks have been spending so much time in the past few months in the air -- and in crowded airports on both sides of the Pacific.

Douglas Ostrom

Land Prices Hit Record Highs In Major Cities

The problem of high land prices in Japan, one of the most serious economic concerns of the government in recent years, grew worse last year. The National Land Agency's January 1, 1990 survey of 16,865 sites across the country showed Osaka to be hardest hit by higher prices. Publication of the results was moved up to March 22 from April 1, the release date in the past for the benchmark price survey, in order to make the information available to the public in a more timely manner.

Osaka, the second-largest city in Japan, attracted speculative money in 1989 seeking another outlet besides too-expensive Tokyo, the NPA survey indicated. Prices for housing, commercial and industrial lots rose by record-high figures -- 56.1 percent, 46.3 percent and 53.4 percent, respectively. The survey reported that higher prices were not limited to Osaka but emanated from Tokyo throughout the country. In particular, some second-tier cities experienced significant increases. The central part of Sendai, the largest city in northern Japan, recorded a 37.3 percent price hike in 1989 because people apparently decided to move there from crowded and expensive Tokyo. Land in Shizuoka prefecture, within commuting distance of Tokyo by high-speed trains and close to an ocean resort, jumped in price more than 20 percent. A 30 percent hike was reported in Yamanashi prefecture, west of Tokyo, where an experimental linear magnetic railroad is expected to be built. Jumps such of these helped to boost the nationwide average increase in the price of land for housing by 17 percent last year, much higher than the 7.9 percent rise in 1988.

While this domino effect has been observed before (see JEI Report No. 39B, October 13, 1989), the government was surprised that the price of housing sites in Tokyo went up 6.6 percent in 1989 compared to the stable 0.4 percent increase recorded the year before. This phenomena ignited fears that the tidal wave may wash back over Tokyo once the ripple effect has subsided in local areas.

Prime Minister Toshiki Kaifu called a ministerial meeting March 23, one day after NLA released the price survey, and reportedly suggested that the government take quick, restrictive actions, including implementation of a price freeze in major cities by instituting government control over land transactions. The government introduced a land price monitoring system in 1987 as an amendment to the National Land Use Planning Act to cope with speculative land activities. Under this system governors can designate some parts of their prefectures for monitoring; people who want to purchase land in these areas must comply with more extensive filing requirements. Prime Minister Kaifu's proposal for price controls is an indication that the monitoring system alone has not been able to restrain price increases.